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Poised for growth.
Focused on success.

2001

ANNUAL REPORT



SOUTHWARD
ENERGY LTD.

Table of Contents

IFC	Corporate Profile
1	Corporate Highlights
2	2001 Performance Highlights
3	President's Message
7	Operations Review
12	Management's Discussion & Analysis
20	Management's Report
21	Auditors' Report
22	Financial Statements
32	Corporate Information

Corporate Profile

Southward Energy is a junior natural gas exploration, development and production company operating in Western Canada. Our philosophy is to demonstrate profitable growth through strict cost control, high working interest, and technical and geographic focus. Our formula for achieving results is simple: we have a clear, focused strategy and we implement it with a high degree of discipline. Almost 90 per cent of our current production is natural gas, produced from our two core focus areas situated in Central Alberta. The remaining production is oil that is integral to our gas operations. The majority of Southward's production is operated with a high working interest, which gives us a large degree of control over the results we deliver to our shareholders.

The Annual Meeting of the Shareholders of the Company will be held at 3:00 p.m., May 8, 2002 in the Viking Room of the Calgary Petroleum Club, 319 - 5 Avenue SW, Calgary, Alberta.

Corporate Highlights

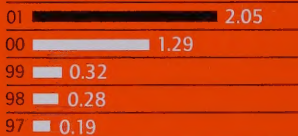
December 31,	2001	2000	Per cent Change
FINANCIAL			
(000s except per share data)			
Revenues (net of royalties)	\$ 63,856	33,245	92
Net earnings	\$ 15,912	11,765	35
Per share – basic	\$ 0.70	0.61	21
Per share – diluted	\$ 0.64	0.51	31
Cash flow	\$ 46,260	25,008	85
Per share – basic	\$ 2.05	1.29	66
Per share – diluted	\$ 1.87	1.07	82
Property and equipment	\$ 181,048	53,771	237
Capital expenditures (including Benson Acquisition)	\$ 102,700	30,393	238
Debt and working capital	\$ (71,209)	(21,054)	(238)
Ratio to annual cash flow	1.5	0.80	92
Shareholders' equity	\$ 50,458	29,276	72
Common shares outstanding, year-end	23,908,157	19,517,888	22
OPERATING			
Production			
Crude oil (Bbls/d)	895	40	2,136
Natural gas (Mcf/d)	38,907	23,700	64
Oil equivalent (Boe/d) (6:1)	7,379	3,990	85
Average selling price			
Crude oil and NGLs (\$/Bbl)	\$ 26.02	38.31	(32)
Natural gas (\$/Mcf)	\$ 5.38	5.11	5
Production expense			
Crude oil (\$/Bbl)	\$ 9.69	6.21	56
Natural gas (\$/Mcf)	\$ 0.50	0.43	17
Oil equivalent (\$/Boe) (6:1)	\$ 3.82	2.60	47
Operating netbacks			
Crude oil and NGLs (\$/Bbl)	\$ 11.62	21.75	(47)
Natural gas (\$/Mcf)	\$ 3.50	3.35	4
Oil equivalent (\$/Boe) (6:1)	\$ 19.88	20.15	(1)
Cash flow netback (\$/Boe) (6:1)	\$ 17.18	17.13	0
Undeveloped land (acres)			
Gross	355,510	134,556	164
Net	332,014	126,404	163
Average working interest	93%	94%	(1)
Wells drilled, net	57.1	35.0	75

Our most significant achievement in 2001 was to establish a second focus area in the West 5 (Cherhill) area of Alberta.

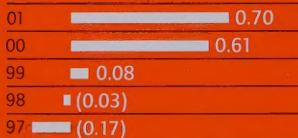
Production (Boe/d 6:1)



Cash flow per share – basic (\$)



Net earnings (loss) per share – basic (\$)



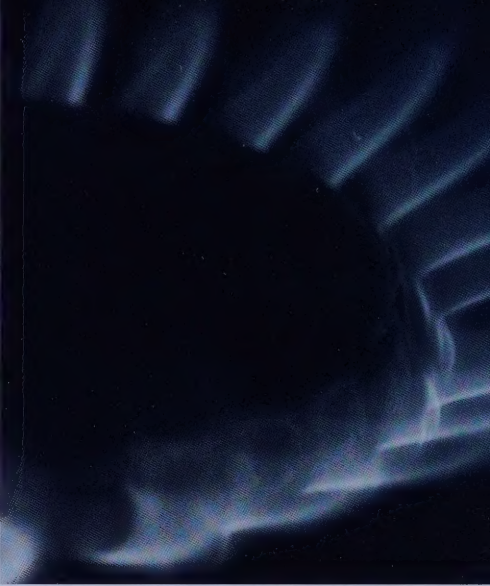
2001 Performance Highlights

Poised for Growth

- Achieved a dominant position in a new focus area in West Central Alberta
- Added 205,610 net acres of undeveloped land
- Maintained average working interest of greater than 85 per cent
- Focused more than 88 per cent of production on natural gas

Focused on Success

- Delivered average production of 7,379 Boe per day, up 85 per cent from 2000
- Replaced production by 2.4 times, adding 6,362 MBoe
- Improved net earnings by 35 per cent, to \$15.9 million
- Improved cash flow by 82 per cent to \$1.87 per share
- Maintained a 37 per cent return on equity
- Achieved undeveloped land base of 332,014 net acres (6:1 conversion)



PRESIDENT'S MESSAGE

2001 was an evolutionary year for Southward. It was a year to aggressively build and position our company for the future. As a result of our efforts, I can say with confidence that we are poised for long-term, sustainable growth, and focused on the right strategy for success.

Our overall performance in 2001 was respectable. We drilled a record number of wells, logged our highest volumes of production – despite less-than-expected initial drilling results in our newly established focus area – and turned in the best-ever levels of cash flow.

Our most significant achievement in 2001 was to establish a second focus area in the West 5 (Cherhill) area of Alberta. The majority of this growth was achieved through two significant acquisitions in early 2001 – Benson Petroleum Ltd. and a complementary asset transaction. In total, we grew our land base by 205,610 net acres at an average cost of \$86 per acre and an average working interest of 97 per cent. We now have a total of 332,014 net undeveloped acres – an increase of more than 160 per cent over year 2000 levels. Of the \$54.5 million development capital allocated for 2001, 44 per cent was directed to land and seismic activity. While this is a substantial sum, it was necessary to establish and maintain a strong growth position in our two focus areas – West 4 and West 5 in West Central Alberta.

Although Southward achieved success in establishing and expanding the West 5 area, early drilling results were disappointing. We drilled 5.3 net wells with an overall success rate of 44 per cent. This, along with the cost of land positioning in the area, resulted in high finding costs in the area for 2001. We have a plan in place to address this in 2002 by allocating a greater percentage of capital to development. As well, our experience in West 5 in 2001 has helped us gain a better understanding of development prospects in the area, and we have begun to shoot additional seismic, including 3-D, to pursue these new prospect types.

In 2002, we are already starting to see improved drilling results in West 5. In fact, since December 2001, Southward has drilled three wells in the area and achieved a 100 per cent success rate. Since acquiring the assets in early 2001, we have increased the associated production from 1,200 Boe per day to more than 1,500 Boe per day through drilling, workovers and optimizations.

Southward also continued its aggressive expansion in the West 4 focus area. Through a combination of land acquisitions and drilling, we continued to strengthen our dominant position in the area, adding 125,000 net undeveloped acres of land. We took advantage of high gas prices in the first half of the year by reducing our targeted reserve threshold for wells drilled. We drilled wells that had attractive cash economics with payouts in just a few months. This, however, resulted in higher finding and development costs.

In 2002, in response to lower gas prices, we have raised our targeted reserve levels for drilling and allocated a greater percentage of our capital spending to drilling and workovers. In the first quarter of 2002, Southward has drilled six wells in West 4 and cased four for gas. Associated finding costs will be at or below our target of \$1.05 for the area.

Besides drilling performance and F&D costs, we faced two other notable challenges in 2001, which we responded to on a priority basis – issues related to staffing and financial flexibility.

Our rapid expansion and busy drilling year required more adequate staffing levels. As a result, we spent a good part of the year restructuring and recruiting qualified people. We are now fully staffed, with the right people for the job ahead.

Financial flexibility also became a challenge in 2001 due to high capital expenses and reduced commodity prices. In 2001, we witnessed large swings in commodity prices – from highs of \$12 per Mcf in February to lows of \$2.30 per Mcf in September. This volatility created a difficult planning environment. By year-end, Southward had lost some financial flexibility by borrowing \$65 million against its line of \$70 million to support the capital program. To address this issue, we have developed a conservative budget for 2002 that builds additional flexibility into the balance sheet and still allows for modest growth.

Another step taken to achieve greater financial flexibility was the disposition of our last remaining heavy oil property in January 2002, with the \$2 million in cash proceeds, plus other considerations, to be applied to our bank debt. As well, we have entered into purchase agreements for our gas that allow us to take advantage of pricing upside, while protecting us from downturns in commodity prices.

In 2002, we will remain focused on our business model that emphasizes strong financial and operational discipline. Our strategy has guided us in achieving our successes to date and it will continue to help us create value in the future.

Unwavering Strategy

At Southward, we maintain a steady commitment to the fundamentals of our business model:

- Operational dominance
- Cost management
- Geographical and geotechnical focus

We are clearly fulfilling our strategy in terms of operational dominance. By establishing a strong foothold in West 5 in 2001, and growing our presence in West 4, we were able to significantly strengthen our dominant position. We operate more than 90 per cent of our assets with an average working interest of greater than 85 per cent. This gives us greater control over costs, the pace of development, and decision-making. That, in turn, leads to greater efficiencies.

Cost management is always a priority for Southward. In 2001, we kept a tight rein on our controllable costs – operating and general and administrative. Although our 2001 finding and development costs were higher than targeted, as I explained earlier, we took immediate, effective action to address the problem. And we are beginning to see positive results.

Our geographical and geotechnical focus demonstrates our commitment to being a natural gas producer in a core area where we have a high degree of expertise. In addition to our acquisition of core assets in 2001, we also sold a number of oil and non-core gas properties to remain focused on this element of our strategy. By concentrating our efforts geographically and technically, we are able to create operational and administrative cost savings through efficient use of infrastructure and people. The high degree of focus will also allow for more efficient reserve additions.

Outlook

Our first priority for 2002 will be to reduce our bank debt and build in more financial flexibility. To this end, we have set our 2002 capital budget at \$20.9 million against an estimated cash flow of \$26.2 million for the year based on a gas price of \$3.29 per Mcf plantgate and on oil price of \$22.06 per barrel wellhead. Close to 85 per cent of our budget is focused directly on development activities, creating far better capital efficiency compared to 2001.

In 2001, we aggressively grew our land base by more than 160 per cent.

We operate more than
90 per cent of our
assets with an average
working interest of
about 85 per cent.

We plan for modest growth in 2002, targeting average annual production of 7,830 Boe per day and exiting the year at more than 8,600 Boe per day. We plan to drill 34 net wells.

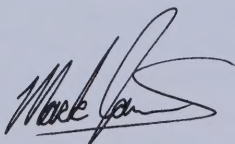
We will concentrate much of our efforts on developing the West 5 area. In the past, we had focused our activities on Paleozoic targets in this region, but success in the Cretaceous zones has caused us to redirect our current activities to Cretaceous horizons. We are confident this will help improve drilling results in 2002.

West 5 is more exploratory in nature than West 4, so it will carry more risk. But the potential rewards in terms of production and reserves will continue to be greater.

At the same time, we will allocate a greater percentage of our capital spending to drilling and workovers in West 4 where we have raised our targeted reserve levels for drilling in 2002. We expect to achieve moderate growth in this area, while adhering to our targeted finding costs.

We are well positioned to reap the benefits of higher gas prices expected toward the end of 2002. And because we expect land costs to be down, we can continue to grow with lower levels of investment. At the same time, through our marketing model, described later in this report, we have protected ourselves from gas price declines in the future.

Southward is strongly positioned for future growth. By maintaining discipline in executing our strategy, we will assure success. I'd like to take this opportunity to thank our board, management and technical and administrative staff for their contributions. With their commitment and talent, we will continue to deliver profitable growth and share performance for our shareholders.



Mark Janisch, P. Eng., MBA
President and Chief Executive Officer

March 22, 2002
Calgary, Alberta

OPERATIONS REVIEW

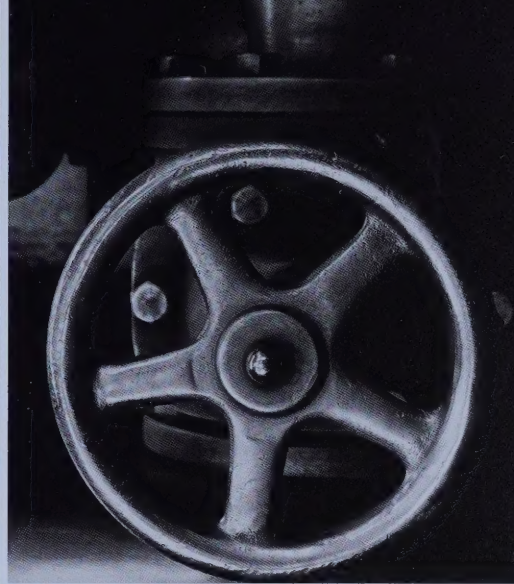
Drilling and Production

Southward expanded its asset base considerably in 2001 through the addition of 6.4 million Boe at a cost of \$102.7 million. Of this, a significant amount is the result of our acquisition of Benson Petroleum Ltd. in the first quarter, which brought 1,800 Boe per day of production before disposition of oil properties. The remaining added production was achieved through drilling.

We achieved a record level of production, increasing our average production by 85 per cent to 7,379 Boe per day for 2001, compared to 3,990 Boe per day in 2000. About 85 per cent of this production is operated by Southward, and almost 90 per cent of it is natural gas.

Southward drilled a record number of wells in 2001, despite disappointing initial drilling results in West 5 (5.3 net wells with an overall success rate of 44 per cent). In total, we drilled 57 net wells and cased 37 net gas wells, with an overall success rate of 60 per cent. This falls short of our targeted success rate of 70 per cent due to the more exploratory nature of both our West 4 and West 5 prospects relative to previous years' drilling activities.

All of Southward's drilling is situated in year-round access areas providing a great deal of flexibility in timing our drilling and seismic programs, and in timing our capital spending. Because all of our wells are shallower than 1,600 metres, we have greater ability to keep drilling costs down.



Southward drilled a record number of wells in 2001, with 57 net wells and 37 cased for gas.

Production by Area

Area	2001			2000		
	Gas Mcf/d	Oil Bbls/d	Total Boe/d (6:1)	Gas Mcf/d	Oil Bbls/d	Total Boe/d (6:1)
West 5	3,451	482	1,058	-	-	-
Lavoy	28,130	1	4,689	17,061	-	2,844
Cold Lake	5,489	-	914	6,124	-	1,021
Other	1,837	412	718	515	40	125
Total	38,907	895	7,379	23,700	40	3,990

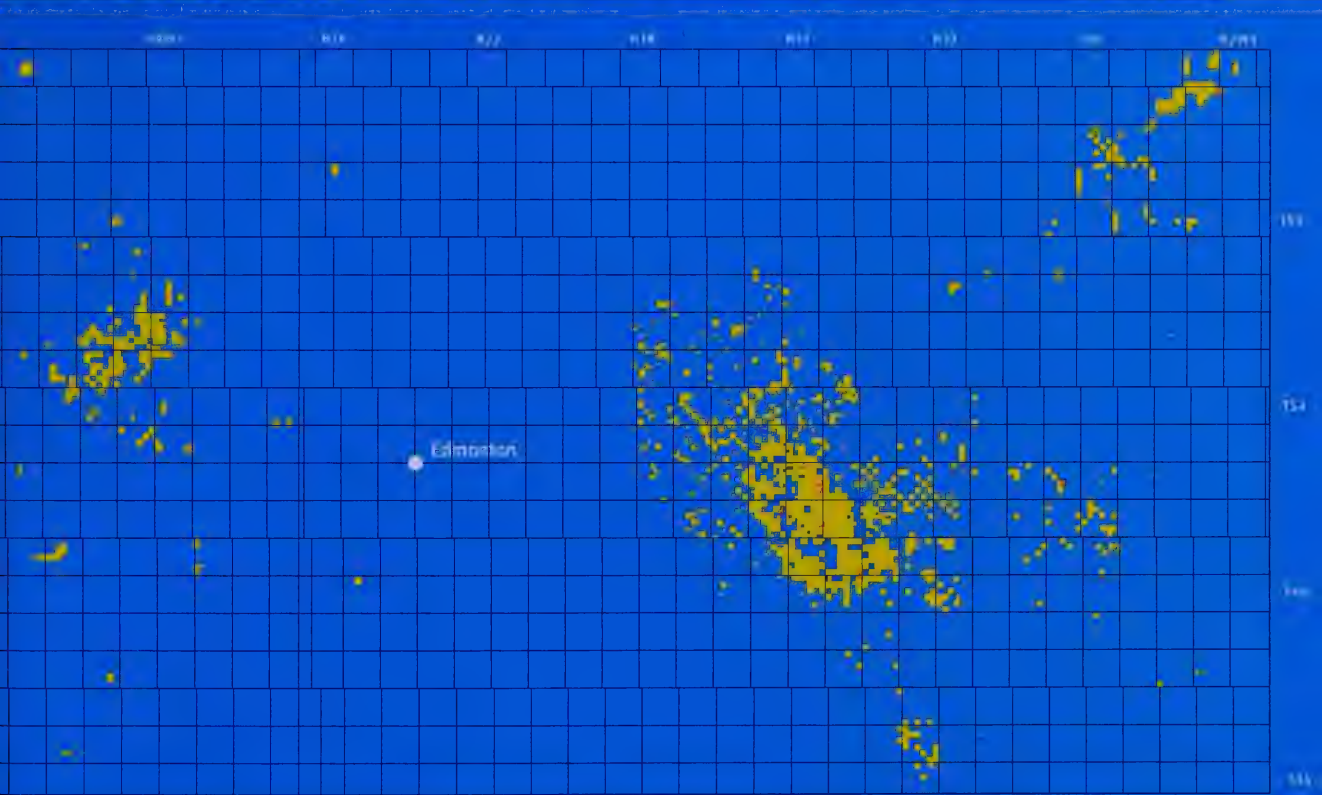
Facilities

Plant	Capacity (Mmcf/d)	Working Interest (%)
Lavoy	18	100
West Lavoy	12	78
Warwick	1	100
Vegreville	6	88
Viking	4	100
Alexis-Cherhill	18	70

We achieved a record level of production, increasing our average production by 85 per cent to 7,379 Boe per day.



Southward Core Areas



Major Properties

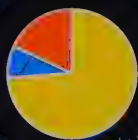
NPV 12%



Alexis-Cherhill
 Lavoy
 Cold Lake/Bonnyville
 Other

Reserve Distribution

By Class



Proved producing
 Proved non-producing
 Probable

Land Position

Growth activities in 2001 dramatically expanded Southward's land base and, in turn, its inventory of drilling prospects. We increased our undeveloped land holdings by 205,610 net acres, bringing our undeveloped net acreage to 332,014, or roughly 500 sections, at the end of 2001. To accomplish this, in part, we spent \$17.6 million in 2001 to acquire 195,158 net acres, representing 17 per cent of our capital budget. Our ratio of net undeveloped land per Boe per day for 2001 was 45 net acres per Boe per day. Our target for a strong land inventory position for our gas-weighted company is 25 or more acres per Boe per day.

Seismic Activity

Consistent with our strategy to maintain ownership and control of all our exploration and production activities, Southward conducted 100 per cent of its seismic acquisitions in 2001. We use seismic data to delineate all of our prospects in an effort to reduce risk and identify more subtle play types. In 2001, we acquired 1,118 kilometres of 2-D seismic data and 7.7 sq. kilometres of 3-D data at a cost of \$4.8 million. Our seismic database consists of 8,572 kilometres of 2-D data and 84 sq. kilometres of 3-D data, valued at approximately \$11 million.

Reserves

McDaniel and Associates has evaluated Southward's reserves as of December 31, 2001. The following table summarizes the key aspects of their report.

	Gas Bcf	Oil Mbbls	Mboe (6:1)	NPV Before Taxes at 10% Discount Rate (millions)
Proven developed producing	50.9	1,984	10,466	\$ 125.8
Proven non-producing	6.4	29	1,096	13.3
Total proven	57.3	2,013	11,562	139.1
Probable	12.8	487	2,621	23.8
Proven plus probable	70.1	2,500	14,183	\$ 162.9

Note: Net Present Values (NPV) based on McDaniel and Associates January 1, 2002 price forecast.

2002 Proven Reserve Reconciliation

	Gas Bcf	Oil Mbbls	Total Mboe (6:1)
January 1, 2001	47.3	0	7,887
Production	(14.2)	(327)	(2,694)
Acquisitions	12.3	2,319	4,369
New development	17.9	21	3,002
Dispositions	(0.6)	-	(102)
Revisions	(5.4)	-	(900)
January 1, 2002	57.3	2,013	11,562

Finding and Development Costs

	Capital Expenditure (millions)	Percentage of Capital Expended	Proven Reserve Additions Mboe	Finding Costs Boe (6:1)
Drilling, completion and facilities	\$ 30.7	29.9	3,002	\$ 10.22
Land	17.6	17.1		\$ 5.86
Seismic	6.2	6.0		\$ 2.07
Acquisitions (net)	48.2	47.0	4,267	\$ 11.30
	102.7	<u>100.0</u>	7,269	\$ 14.12
Revisions			(900)	
Total	\$ 102.7		6,369	\$ 16.13

Recycle Ratio

	2001	2000
Cash flow netback	\$ 17.18	17.13
Proven finding & development costs	\$ 16.13	7.57
Proven recycle ratio	1.1	2.3

Marketing

Southward's approach to marketing its natural gas is based on a model that takes advantage of pricing upside, but mitigates risk related to volatile commodity prices. For 2002, about 50 per cent of Southward's portfolio, committed to put options at a net floor price of \$2.38 per Mcf, ensures a minimum price for gas, but does not impose a price cap. In a strong market this ensures revenue for capital expenditures, but does not eliminate the upside. Another 30 per cent of our portfolio is dedicated to fixed contracts at a price of \$3.55 per Mcf, and the final 20 per cent is split between the spot market and aggregators.

The model portfolio weighting we will maintain into the 2002-2003 winter and summer gas periods consists of 40 per cent puts and 25 per cent fixed contracts, with the remainder allocated to spot and aggregator contracts. This allows us to ensure an adequate capital budget to grow, but does not remove the potential upside associated with higher gas prices.



MANAGEMENT'S DISCUSSION & ANALYSIS

The following report has been prepared by management and should be read in conjunction with the consolidated financial statements for the year ended December 31, 2001.

The following tables outline a summary of operations, including netbacks for 2001 compared to 2000, and netbacks on a product basis (6:1 conversion):

Production	2001 7,379 Boe/d		2000 3,990 Boe/d		% Change 2001-2000 85%	
	000s	\$/Boe	000s	\$/Boe	Total	Per Unit
Operating netback:						
Oil and natural gas sales	\$ 84,944	31.54	44,898	30.74	89	3
Royalties	(21,606)	(8.02)	(12,187)	(8.35)	77	(4)
Alberta Royalty Tax Credit	500	0.19	517	0.35	(3)	(48)
Production expenses	(10,292)	(3.82)	(3,802)	(2.60)	171	47
OPERATING NETBACK	53,546	19.89	29,426	20.14	82	(1)
General and administrative expenses	(2,242)	(0.83)	(1,250)	(0.86)	79	(3)
Interest expense	(3,557)	(1.32)	(1,144)	(0.78)	211	69
Income taxes, current	(1,387)	(0.51)	(1,898)	(1.30)	(27)	(60)
Other	(100)	(0.04)	(125)	(0.09)	(20)	(56)
CASH FLOW NETBACK	46,260	17.18	25,009	17.11	85	0
Depletion and depreciation	(26,778)	(9.94)	(7,752)	(5.31)	245	87
Site restoration expense	(457)	(0.17)	(334)	(0.23)	37	(26)
Future income taxes	(3,232)	(1.20)	(5,300)	(3.63)	(39)	(67)
Other	119	0.04	142	0.10	(16)	(55)
NET EARNINGS	\$ 15,912	5.91	11,765	8.04	35	(27)

Netback by Product – 2001 (6:1 conversion)

Production	Crude Oil & NGLs 895 Bbls/d		Natural Gas 38,907 Mcf/d		Total Equivalent 7,379 Boe/d	
	000s	\$/Bbl	000s	\$/Mcf	000s	\$/Boe
Operating netback:						
Oil and natural gas sales	8,495	26.02	76,449	5.38	84,944	31.54
Royalties	(1,537)	(4.71)	(20,069)	(1.41)	(21,606)	(8.02)
Alberta Royalty Tax Credit	0.00	0.00	500	0.04	500	0.19
Production expenses	(3,164)	(9.69)	(7,127)	(0.50)	(10,292)	(3.82)
OPERATING NETBACK	3,794	11.62	49,752	3.50	53,546	19.89

Revenues

Gross production revenues in 2001 increased by 89 per cent to \$84.9 million from \$44.9 million in 2000. This substantial increase was due primarily to higher production volumes.

Natural gas production increased 64 per cent to 38.9 Mmc/d in 2001 from 23.7 Mmc/d in 2000. Gas prices averaged \$5.38 per Mcf in 2001 compared to \$5.11 in 2000, an increase of five per cent. Oil prices averaged \$26.01 per barrel in 2001, compared to \$38.31 per barrel in 2000, a decrease of 32 per cent.

Royalties

In 2001, royalties increased by 77 per cent to \$21.6 million from \$12.2 million in 2000, due to higher gross revenues resulting from increased gas production volumes. The combined royalty rate on oil and gas production, before Alberta Royalty Tax Credit (ARTC), decreased to 25 per cent from 27 per cent in 2000. Southward earned the \$500,000 maximum amount eligible for ARTC in 2001, a three per cent decrease from \$517,000 in 2000.

Production Expenses

Increased production volumes and higher costs associated with oil production from Benson properties caused operating costs to increase to \$10.3 million in 2001 (2000 – \$3.9 million). 2001 costs equated to \$3.82 per Boe, compared to \$2.60 per Boe in 2000, an increase of 47 per cent. The \$3.82 per BOE in 2001 consists of \$3.00 per Boe of gas production expenses and \$9.69 per Boe of oil expense. Most of the Benson properties with high operating costs have since been disposed of.

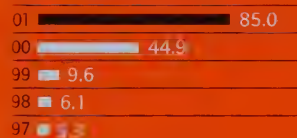
General and Administrative Expenses

General and administrative expenses in 2001 increased to \$2,242,100 compared to \$1,250,252 in 2000. Most of the increase in administrative expenses is attributable to the increase in the number of full-time employees compared to 2000. Other factors that contributed to the increase included the acquisition of more office space and costs associated with the Benson acquisition. On a Boe basis, administrative expenses remained virtually unchanged from the previous year – \$0.83 compared to \$0.86 in 2000, a decrease of three per cent.

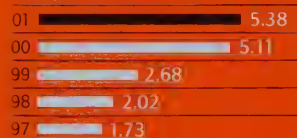
Interest Expense

Interest expense increased from \$1,144,354 in fiscal 2000 compared to \$3,556,885 in fiscal 2001, a 211 per cent increase. This was due to a substantial increase in the Company's bank loan, which totaled \$64.7 million in 2001 compared to \$20.2 million in 2000. The loan was used to assist in the financing of a significant property acquisition in February 2001, completing the Benson acquisition in March 2001 and maintaining an active drilling, completion and tie-in program throughout 2001.

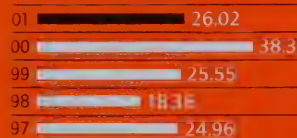
Gross revenue (\$ millions)



Gas price (\$ per Mcf)



Oil price (\$ per Bbl)



Depletion, Depreciation and Site Restoration

The depletion and depreciation provision increased to \$26.8 million in 2001 from \$7.8 million in 2000. This significant increase is due to increased production volumes and a higher depletion rate that, as previously disclosed, included a large "tax bump" related to the Benson transaction. Depletion on oil and gas properties was provided at the rate of \$9.94 per Boe for the current fiscal year compared to \$5.31 for the previous fiscal year. These rates are based on the industry standard assumption that 6 Mcf of natural gas is equivalent to one barrel of oil.

The site restoration provision was \$457,130 (2000 - \$334,000) and is intended to cover the liability associated with future well abandonment and site restoration costs. At December 31, 2001, the estimated liability for future well abandonment and site restoration costs was \$4,806,000 (2000 - \$2,715,000) of which \$2,668,988 (2000 - \$918,679) has been recorded in the financial statements.

Ceiling Test

Southward applies a ceiling test quarterly as required under its policy of accounting for oil and gas properties and equipment using the full cost method. This test ensures the capitalized/carrying costs of developed properties, net of deferred income taxes and future site restoration and abandonment costs, does not exceed the value of future net revenues from oil and gas reserves, using year-end prices, less future general and administrative expenses related to production of those reserves, financing costs, estimated future abandonment costs and income taxes. As at December 31, 2001 and 2000, the ceiling test computation revealed no write-down was required.

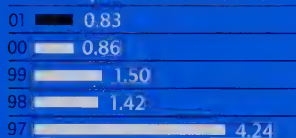
Income Taxes

Current income taxes include federal and provincial tax payable of \$1,386,529, a decrease of \$511,574 from the 2000 amount of \$1,898,103.

Southward's future income tax liability was \$58,364,231 at December 31, 2001, an increase of \$50,747,526 from 2000. This increase was largely attributable to the Benson acquisition. Effective January 1, 2000, Southward adopted the new accounting recommendation for accounting for income taxes using the liability method.

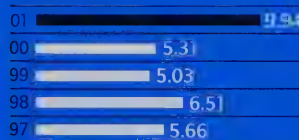
At December 31, 2001, Southward had an estimated \$54.2 million of tax pools available to be deducted against future taxable income, compared to \$36.9 million at December 31, 2000 as follows:

G & A expense (\$ per Boe) (6:1)

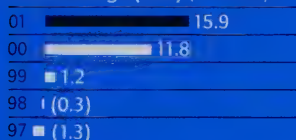


Depletion expenses

(\$ per Boe) (6:1)



Net earnings (loss) (\$ millions)



(000s)	Rate (%)	2001	2000
Canadian oil & gas property expense	10	\$ 21,886	20,005
Canadian development expense	30	13,072	5,926
Canadian exploration expense	100	0	0
Undepreciated capital cost	25	18,745	10,819
Share issue costs	25	497	143
		\$ 54,200	36,893

Cash Flow from Operations and Net Earnings

Southward had significantly higher net earnings and cash flow in 2001 as a result of increased production and product prices earlier in the year. Net earnings went to \$15.9 million in fiscal 2001 from \$11.8 million in 2000, a 35 per cent increase. This equated to \$0.70 per share basic (\$0.64/diluted) compared to 2000 of \$0.61 per share basic (\$0.51/diluted).

Cash flow from operations increased 85 per cent to \$46.2 million, \$2.05 per share basic (\$1.87/diluted), from \$25.0 million, \$1.29 per share basic (\$1.07/diluted, for 2000). On a Boe basis, cash flow netback was virtually unchanged at \$17.18 for 2001 compared to \$17.13 for 2000.

Capital Expenditures

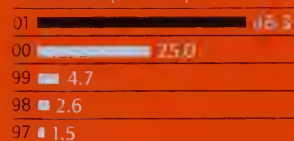
In 2001, the Company carried out a full-cycle exploration and development capital program as well as completing several property acquisitions. In February 2001, Southward made an acquisition in the Alexis area of Alberta for a purchase price of \$13.0 million. Also, effective March 5, 2001, Southward completed the acquisition of Benson Petroleum Ltd., for an aggregate value of approximately \$97.0 million. Proceeds of \$53.2 million were received by Southward for disposing of certain Benson properties throughout 2001.

In fiscal 2001, capital expenditures aggregated \$60.9 million as illustrated in the following tables:

(000s)	2001	2000
Property acquisition	\$ 18,473	9,400
Property disposition	(12,795)	(3,156)
Land acquisition	17,624	4,990
Geological and geophysical	6,242	2,846
Drilling and completion	18,286	9,428
Well equipment and facilities	11,533	6,741
Other	1,496	144
Expenditures on property and equipment	60,859	30,393
Benson acquisition (includes debt and acquisition costs)	41,841	0
Total additions to property and equipment	\$ 102,700	30,393

Net earnings increased by 35 per cent, from \$11.8 million in 2000 to \$15.9 million in 2001.

Cash flow (\$ millions)



Cash flow netback (\$ per Boe) (6:1)



Operating netbacks (\$ per Boe) (6:1)



Production expense (\$ per Boe) (6:1)

01	3.82
00	2.60
99	3.86
98	3.57
97	4.23

Page 16

2001 ANNUAL REPORT

Liquidity and Capital Resources

At December 31, 2001, Southward had 23.9 million common shares outstanding, compared to 19.5 million common shares outstanding as of December 31, 2000. This increase is due largely to outstanding warrants having been exercised.

At December 31, 2001, Southward had 2,086,106 stock options for common shares outstanding of which 1,166,606 were exercisable at an average price of \$1.36 equating to proceeds of \$1.6 million.

At December 31, 2001, the Company had a \$70 million demand revolving loan facility bearing interest at prime plus 0.5 per cent. At December 31, 2001, the amount drawn under this facility was \$64.7 million compared to \$20.1 million at December 31, 2000. This facility was used to finance our capital spending program, as well as the acquisition of Benson Petroleum Ltd. and other properties.

At December 31, 2001, the working capital deficiency was \$6,519,477 (2000 – \$941,000). The combined debt and working capital deficiency was \$71,209,302 (2000 – \$21,054,000), which was approximately 1.5 times our 2001 cash flow from operations compared to a 0.8 ratio at year-end 2000.

Net Asset Value

December 31, (000s)	2001		2000
	Proven	Established*	Established*
Oil and gas reserves @ 10% discount (before tax)	\$ 139,102	151,012	118,000
Undeveloped lands & seismic data	30,265	30,265	10,600
Note receivable	0	0	378
Inventory	1,652	1,652	1,123
Long-term investment	0	0	2,538
Working capital (deficiency)	(6,519)	(6,519)	(941)
Bank loan	(64,689)	(64,689)	(20,113)
	99,811	111,721	111,585
Net asset value per common share (basic)	\$ 4.17	4.67	5.72
Common shares outstanding at year-end	23,908,157	23,908,157	19,517,888

* Established represents proven plus one half probable.

Sensitivity Analysis

The Company's sensitivity to fluctuations in price and production volumes at December 31, 2001 is illustrated in the following table:

	Impact on Cash Flow Per Common Share (Basic)
Commodity price changes	
Natural gas (\$0.10/Mcf)	\$ 0.05
Oil (\$1.00/Bbl)	\$ 0.01
Production volume changes	
Natural gas (1 Mmcfd)	\$ 0.04
Oil (100 Bbls)	\$ 0.03

Business Risks

Southward, like all oil and gas exploration companies, is subject to inherent risks associated with exploration, development, reservoir performance, marketing, price fluctuations, interest rates and money market exchange rates. Management attempts to manage this risk by designing capital programs tempered with low, medium and high risk projects, with the understanding that higher risk projects often carry higher reward and longer term value.

Southward has added competent technical staff and uses up-to-date technology to not only find, but also maximize the return from the Company's producing properties. The Company maintains an insurance program consistent with industry practice to protect against destruction of assets, safety and environmental risks, and other business interruptions.

Southward is exposed to a variety of market risks including changes in commodity process, foreign currency exchange rates and interest rates. The Company's financial results can be significantly affected by the prices received for oil and natural gas production as commodity prices fluctuate in response to changing market forces. This volatility is expected to continue. The Company's financial results are exposed to fluctuations in the exchange rate between the Canadian and U.S. dollars. Crude oil and, to a large extent, natural gas prices are based on reference prices denominated in U.S. dollars, while the majority of expenses are denominated in Canadian dollars. Southward may be exposed to changes in interest rates as the Company's credit facilities are based on our lenders' prime lending rates. The Company uses various risk management activities to mitigate the effects of these market risks. Derivative instruments are not used for speculative purposes.

Financial Controls

Southward is typical in that it has a sophisticated accounting system in place to handle the specialized accounting needs pertaining to an oil and gas exploration and production company. The Company employs well trained accounting personnel who are experienced with the needs unique to the industry. Because Southward is a public company trading on the Toronto Stock Exchange and listed with the securities commissions in the provinces of Ontario, Alberta and British Columbia, it is subject to stringent regulatory approvals and reporting practices. These require interim financial statements (unaudited) at the end of each quarter and audited financial statements annually. Accordingly, an accounting system, with budgetary and reporting procedures, is in place to ensure compliance and to provide accurate and generally accepted financial statements. Southward believes it has sufficient budget and reporting procedures in place to provide maximum accountability.

Safety and Environment Issues

Southward is committed to the protection and preservation of the environment, and to the health and safety of its employees and the public in conducting its business. To guide Company personnel in fulfilling daily operating and project responsibilities, Southward has adopted a series of environmental principles. The Company will apply the expertise necessary to implement these principles and will require contractors providing services to operate in a manner consistent with corporate policies. These guiding principles reflect current environmental legislation and accepted industry practice, and are incorporated into Southward's ongoing activities.

Financial Review

MANAGEMENT'S REPORT

The accompanying consolidated financial statements of Southward Energy Ltd. and all the information in this annual report are the responsibility of management and have been approved by the Board of Directors.

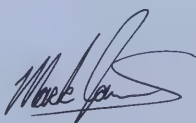
The financial statements have been prepared by management in accordance with generally accepted accounting principles and where alternative accounting methods exist, management has chosen those it deems most appropriate in the circumstances.

Financial statements are not precise since they include certain amounts based on estimates and judgments, and where applicable such amounts have been determined on a reasonable basis in order to ensure the financial statements are presented fairly in all material respects. Management has prepared the financial information presented elsewhere in this annual report and has ensured it is consistent with that in the financial statements.

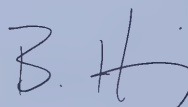
The Company maintains systems of internal accounting and administrative controls, consistent with reasonable cost, which are designed to provide reasonable assurance that the financial information is relevant, reliable and accurate, and that the Company's assets are appropriately accounted for and adequately safeguarded.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and is ultimately responsible for reviewing and approving the financial statements. The Board carries out this responsibility principally through its Audit Committee which includes three non-management directors.

The financial statements have been audited by Deloitte & Touche LLP, the external auditors, in accordance with generally accepted auditing standards on behalf of the shareholders. Deloitte & Touche LLP have full and free access to the Audit Committee.



Mark Janisch
President and Chief Executive Officer



Barry Herring
Vice President Finance and
Chief Financial Officer

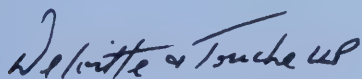
AUDITORS' REPORT

To the Shareholders of Southward Energy Ltd.

We have audited the consolidated balance sheets of Southward Energy Ltd. as at December 31, 2001 and 2000 and the consolidated statements of operations and retained earnings and of cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2001 and 2000 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.



Deloitte & Touche LLP
Chartered Accountants
Calgary, Alberta
February 22, 2002

CONSOLIDATED BALANCE SHEETS

As at December 31, 2001 2000

ASSETS

Current		
Accounts receivable	\$ 9,256,914	10,100,617
Deposits and other	856,188	325,173
Total current assets	<u>10,113,102</u>	<u>10,425,790</u>
 Note receivable (note 3)	 0	 378,098
Inventory	1,652,116	1,122,653
Long-term investment (note 2)	0	2,538,222
Deferred charges (note 4)	0	1,174,750
Property and equipment (note 5)	181,048,834	53,770,788
	<u>\$ 192,814,052</u>	<u>69,410,301</u>

LIABILITIES AND SHAREHOLDERS' EQUITY

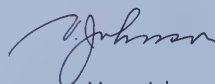
Current		
Accounts payable and accrued liabilities	\$ 16,192,438	10,295,345
Income taxes payable	321,521	929,344
Deferred revenue	118,620	142,344
Total current liabilities	<u>16,632,579</u>	<u>11,367,033</u>
 Bank loan (note 6)	 64,689,825	 20,112,922
Future site restoration and abandonment costs	2,668,988	918,679
Future income taxes (note 7)	58,364,231	7,616,705
Deferred revenue	0	118,619
 Shareholders' equity		
Share capital (note 8)	22,284,332	17,014,300
Retained earnings	28,174,097	12,262,043
Total shareholders' equity	<u>50,458,429</u>	<u>29,276,343</u>
	<u>\$ 192,814,052</u>	<u>69,410,301</u>

See accompanying notes

On behalf of the Board,



Mark Janish
Director



Verne Johnson
Director

CONSOLIDATED STATEMENTS OF OPERATIONS AND RETAINED EARNINGS

For the years ended December 31,	2001	2000
REVENUES		
Oil and natural gas sales	\$ 84,943,754	44,897,998
Other income	18,582	17,510
	<u>84,962,336</u>	<u>44,915,508</u>
Royalties, net	21,106,270	11,670,306
	<u>63,856,066</u>	<u>33,245,202</u>
EXPENSES		
Production	10,291,538	3,801,720
General and administrative	2,242,100	1,250,252
Interest	3,556,885	1,144,354
Depletion and depreciation	26,777,830	7,751,584
Site restoration	457,130	334,000
	<u>43,325,483</u>	<u>14,281,910</u>
Earnings before income taxes	20,530,583	18,963,292
Income taxes (note 7)		
Current	1,386,529	1,898,103
Future	3,232,000	5,300,000
	<u>4,618,529</u>	<u>7,198,103</u>
Net earnings	15,912,054	11,765,189
Retained earnings, beginning of year	12,262,043	927,854
Adoption of liability method of accounting for future income taxes (note 7)	0	(431,000)
Retained earnings, end of year	<u>\$ 28,174,097</u>	<u>12,262,043</u>
Basic Net Earnings per share (note 9)	<u>\$ 0.70</u>	<u>0.61</u>
Diluted Net Earnings per share (note 9)	<u>\$ 0.64</u>	<u>0.51</u>

See accompanying notes

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the years ended December 31,	2001	2000
Cash provided by (used in):		
OPERATING ACTIVITIES		
Net Earnings	\$ 15,912,054	11,765,189
Add (deduct) non-cash items:		
Depletion and depreciation	26,777,830	7,751,584
Site restoration	457,130	334,000
Future income taxes	3,232,000	5,300,000
Deferred revenue	(118,619)	(142,344)
Cash flow from operations	46,260,395	25,008,429
Change in non-cash working capital	4,542,010	(299,639)
Cash provided by operating activities	50,802,405	24,708,790
INVESTING ACTIVITIES		
Expenditures on property and equipment	(60,859,462)	(30,393,076)
Benson acquisition (note 2)	(28,693,670)	0
Benson shares acquired previously (note 2)	2,538,222	(2,538,222)
Inventory increase	(529,462)	(1,038,309)
Deferred charges	1,174,750	(1,174,750)
	(86,369,622)	(35,144,357)
FINANCING ACTIVITIES		
Increase in bank loan	29,919,087	10,105,942
Issue of common shares	5,270,032	153,235
Share issue expense	0	(2,522)
Note receivable	378,098	178,912
	35,567,217	10,435,567
Increase (decrease) in cash	0	0
Cash, beginning of year	0	0
Cash, end of year	\$ 0	0
Basic Cash Flow from operations per share (note 9)	\$ 2.05	1.29
Diluted Cash Flow from operations per share (note 9)	\$ 1.87	1.07

See accompanying notes

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(audited)

December 31, 2001 and 2000

1. Summary of Significant Accounting Policies

Southward Energy Ltd. is a publicly traded company engaged in the oil and gas business and incorporated under the Alberta Business Corporations Act. These consolidated financial statements are prepared in accordance with generally accepted accounting principles, as follows:

a) Basis of Consolidation

These consolidated financial statements include the accounts of Southward Energy Ltd. (the "Company") and its wholly-owned subsidiary, 925011 Alberta Ltd., which together own 100 per cent of the Southward Energy Partnership.

b) Capitalized Costs

The Company follows the full cost method of accounting whereby all costs associated with the exploration for, and development of, oil and gas reserves, whether productive or non-productive, are capitalized in a single Canadian cost centre. Such costs include land acquisition, drilling, geological and geophysical expenses related to exploration and development activities.

Gains or losses are not recognized upon the disposition of oil and gas properties unless such a disposition would change the depletion rate by 20 per cent or more. Gains and losses are recognized upon the disposition of other assets.

c) Depletion and Depreciation

Depletion of petroleum and natural gas properties, and depreciation of production equipment, is provided using the unit of production method based on estimated proved petroleum and natural gas reserves as determined by independent engineers.

The depletion and depreciation base includes total capitalized costs, less costs of unproved properties, net of impairment and future salvage values, plus provision for future development costs of undeveloped reserves, as determined by independent engineers and management estimates.

The relative volumes of oil and natural gas reserves and production are converted to equivalent barrels of oil based on the relative energy content of each product on a 6 to 1 basis.

Furniture, fixtures and office equipment are carried at cost and are depreciated over the estimated useful lives of the assets at rates of 20 per cent to 30 per cent calculated on a declining basis.

d) Future Site Restoration and Abandonment Costs

The Company annually estimates the future costs associated with the site restoration and abandonment of well sites and facilities by specific areas. An accrual for abandonment is made using the unit of production method. Actual abandonment expenditures are charged as incurred to the accumulated abandonment provision.

e) Ceiling Test Limitations

The Company applies a ceiling test to capitalized costs, net of future income taxes and future site restoration and abandonment costs, to ensure that the net carrying value does not exceed the estimated value of future net revenues from production of proven reserves plus undeveloped properties less future production-related general and administrative expenses, financing costs, estimated future abandonment costs and income taxes. Any reduction in the net carrying value of property and equipment as a result of the ceiling test is charged to operations.

The calculation of future net revenues is based on sales prices, costs and regulations in effect at year-end. The carrying value of undeveloped properties is reviewed periodically and written down to net realizable value if impairment is determined.

f) Inventory

Inventory consists primarily of drilling and facility equipment and is carried at the lower of cost and replacement cost.

g) Future Income Taxes

Effective January 1, 2000, the Company adopted the new accounting recommendation of the Canadian Institute of Chartered Accountants, for accounting for income taxes using the liability method. Under this method, future income tax assets and liabilities are measured based on temporary differences between the carrying values of assets and liabilities and their tax basis. Future income tax expense (recovery) is computed based on the change during the year in the future tax assets and liabilities. Effects of changes in tax laws and tax rates are recognized when substantially enacted.

h) Deferred Revenue

Payments received for oil and gas not delivered are deferred and are recorded as revenue on a straight line basis over the life of each contract.

i) Per Share Amounts

Basic earnings per share and basic cash flow from operations per share are computed by dividing earnings and cash flow from operations by the weighted average number of common shares outstanding during the year. Diluted per share amounts reflect the potential dilution that could occur if options or warrants to purchase common shares were exercised. The treasury stock method is used to determine the dilutive effect of stock options and warrants, in accordance with new standards approved by the Canadian Institute of Chartered Accountants.

j) Financial Instruments

The fair value of the Company's accounts receivable, deposits and other, and accounts payable and accrued liabilities, approximate the respective carrying values due to their short-term nature. The Company's long-term bank loan bears interest at a floating market rate; accordingly, the fair value approximates the carrying value.

k) Hedging Contracts

The Company may enter into contracts to manage its exposure to commodity price fluctuations. Gains and losses on commodity price hedges are included in income at the time of the sale of the related production.

l) Joint Ventures

Certain of the Company's exploration, development and production activities are conducted jointly with others and, accordingly, these financial statements reflect only the Company's proportionate interest in such activities.

m) Stock Option Plan

The Company has granted stock options to certain directors, officers and employees. No compensation expense is recognized for this plan when stock or stock options are issued. Any consideration paid on exercise of stock options or purchase of stock is credited to share capital.

2. Benson Acquisition

Effective March 5, 2001, the Company completed the acquisition of all the issued and outstanding shares of Benson Petroleum Ltd. ("Benson") for \$3.05 cash per share, for an aggregate value, including assumed debt, of \$93,196,414. Prior to the completion of the acquisition, in December 2000, Southward Energy Ltd. had acquired 1,257,700 common shares of Benson for \$2,538,222. Also in conjunction with the acquisition, the Company caused Benson to sell certain oil and gas properties to a third party for cash proceeds of approximately \$53 million.

The acquisition has been accounted for using the purchase method of accounting, effective from March 1, 2001.

Consideration given:

Cash for shares	\$ 75,587,617
Acquisition costs	<u>6,176,970</u>
	81,764,587

Cash proceeds received on sale	<u>(53,070,917)</u>
	<u>\$ 28,693,670</u>

Allocation of purchase price:

Property and equipment	\$ 93,196,414
Future site restoration and abandonment costs	(1,293,178)
Debt including working capital deficiency	(15,694,040)
Future income tax liability	<u>(47,515,526)</u>
	<u>\$ 28,693,670</u>

3. Note Receivable

In conjunction with the new financing and change in management in late 1997, the Company agreed to enter into a loan arrangement whereby the President would be advanced funds to purchase common shares from treasury. This loan was approved by shareholders in the Special Meeting held December 17, 1997. The loan was repaid in full in April 2001.

4. Deferred Charges

Deferred charges of \$1,174,750 at December 31, 2000 represented the unamortized portion of two gas contracts which were closed out during 2000. The initial cash payment of \$1,546,837 was amortized over the original terms of the contracts, ending in 2001.

5. Property and Equipment

	2001	2000
Oil and gas properties	\$ 228,208,514	\$ 74,335,452
Furniture and other	<u>593,670</u>	<u>410,856</u>
	228,802,184	74,746,308
Accumulated depletion and depreciation	<u>(47,753,350)</u>	<u>(20,975,520)</u>
	<u>\$ 181,048,834</u>	<u>\$ 53,770,788</u>

As at December 31, 2001, \$30,265,127 (2000 - \$10,603,953) was excluded from the depletion calculation, which was \$19,558,000 (2000 - \$6,758,849) for undeveloped land and \$10,707,127 (2000 - \$3,845,104) for seismic data.

Future site restoration and abandonment costs are estimated to be \$4,806,000 (2000 – \$2,715,000) of which \$2,668,998 has been recorded (2000 – \$918,679).

6. Bank Loan

In March 2001, the Company arranged a new credit facility with a major Canadian bank. This facility is a demand revolving loan facility to a maximum of \$70,000,000 bearing interest at prime plus one half of one per cent. Collateral for the facility consists of a general security agreement with a floating charge on land. This facility is subject to an annual review, with the next review being June 30, 2002. No principal repayments have been stipulated by the bank for 2002 provided that the terms of the facility are complied with, and that there is no adverse change in the financial position of the Company. As at December 31, 2001, \$64,689,825 (2000 – \$20,112,922) was drawn under this loan arrangement.

7. Future Income Taxes

Effective January 1, 2000, the Company adopted the new accounting recommendation of the Canadian Institute of Chartered Accountants, "Income Taxes." The standard has been adopted retroactively without restatement of the prior year financial statements. The impact of this restatement relating to prior years was to record a future income tax liability of \$949,000, decrease the Company's retained earnings by \$431,000 and increase property and equipment by \$518,000.

There was no significant impact on 2000 net earnings as a result of adopting the liability method.

The provision for future income taxes differs from the amount computed by applying the combined federal and provincial tax rate of 42.62 per cent to earnings before income taxes. The difference results from the following:

	2001	2000
Computed expected provision (recovery) for income taxes	\$ 8,750,000	\$ 8,471,000
Effect on taxes of:		
Non-deductible crown royalties	6,270,000	3,242,000
Alberta royalty tax credit	(213,000)	(230,000)
Resource allowance	(7,105,000)	(4,395,000)
Decrease in provincial tax rate	(2,677,000)	0
Capital taxes	381,000	0
Other	(787,471)	110,103
	<u>\$ 4,618,529</u>	<u>\$ 7,198,103</u>

The major components of the future income tax liability at December 31, 2001 using the combined federal and provincial income tax rates of 42.62 per cent are as follows:

	Future Tax Asset (Liability)
Property and equipment	\$ (59,476,231)
Future site restoration	1,112,000
Balance, December 31, 2001	<u>\$ (58,364,231)</u>

8. Share Capital

Authorized

Unlimited number of common shares

Unlimited number of preferred shares

Common shares issued:

	2001		2000	
	Number	Consideration	Number	Consideration
Balance, beginning of year	19,517,888	\$ 17,014,300	19,388,588	\$ 16,863,587
Shares issued				
Exercise of options	583,537	701,953	123,300	146,035
Exercise of warrants	3,806,732	4,568,079	6,000	7,200
Share issue costs	0	0	0	(2,522)
Balance, end of year	23,908,157	\$ 22,284,332	19,517,888	\$ 17,014,300

Warrants issued and outstanding:

	Dec. 31, 2000	Issued	Exercised	Dec. 31, 2001	Expiry Date
2000 issue @\$1.20	6,344,562	0	(6,344,562)	0	Sept. 15, 2001

In September 1999, the Company completed a private placement of 6,354,562 common shares in exchange for cash of \$3,710,534 and marketable securities of \$836,739. Attached to these private placement shares issued were 6,354,562 share purchase warrants. Each warrant entitled the holder to acquire 0.6 of one common share and the purchase price for each whole common share acquired was \$1.20. During the year ended December 31, 2000, 10,000 warrants were exercised to acquire 6,000 common shares. The remaining warrants outstanding at December 31, 2000 were exercised during the fiscal year 2001 to acquire 3,806,732 shares.

Stock Options

The Board of Directors has approved the granting of options to certain directors, officers and employees to purchase the Company's common shares.

A summary of the status and changes in the number of the Company's stock options is presented below:

	2001		2000	
	Number of Options	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price
Outstanding, beginning of year	1,867,643	\$ 1.39	1,781,443	\$ 1.19
Granted	1,072,000	\$ 5.59	209,500	\$ 2.92
Exercised	(583,537)	\$ 1.20	(123,300)	\$ 1.18
Cancelled	(270,000)	\$ 4.75	0	
Outstanding, end of year	2,086,106	\$ 3.16	1,867,643	\$ 1.39
Options exercisable, end of year	1,166,606	\$ 1.36	996,337	\$ 1.26

Options outstanding at December 31, 2001:

Range of Exercise Prices	Number Outstanding	Options Outstanding		Number Exercisable	Options Exercisable	
		Average Remaining Life in Years	Weighted Average Exercise Price		Average Remaining Life in Years	Weighted Average Exercise Price
\$0.75 – 1.65	986,206	1.9	\$ 1.06	986,206	1.9	\$ 1.06
\$2.15 – 3.60	489,400	4.4	\$ 3.37	180,400	3.6	\$ 2.99
\$5.35 – 6.00	486,500	5.0	\$ 5.97			
\$7.00 – 8.15	124,000	4.9	\$ 8.02			
	2,086,106			1,166,606		

The Company presently has the maximum number of options allowed under the plan fixed at 3,500,000 which is reduced to 2,547,669 after deducting options previously granted and exercised. This maximum is further restricted so as not to exceed 10 per cent of the actual shares issued and outstanding at any time. At December 31, 2001, the number of shares issued and outstanding was 23,908,157 and, therefore, the maximum number of options permitted to be issued was 2,390,816.

9. Per Share Amounts

Effective January 1, 2001, the Company retroactively adopted the new recommendations of the Canadian Institute of Chartered Accountants with respect to the computation, presentation and disclosure of earnings and cash flow from operations per share. Under the new standard, the treasury stock method is used instead of the imputed earnings method to determine the dilutive effect of stock options and warrants. Under the treasury stock method, only "in the money" dilutive instruments impact the diluted calculations.

Prior year diluted net earnings per share and cash flow from operations per share have been restated for this change.

	2001	2000
Basic		
Earnings per share	\$ 0.70	\$ 0.61
Cash flow from operations per share	\$ 2.05	\$ 1.29
Weighted average number of shares outstanding	22,599,501	19,452,588
Diluted		
Earnings per share	\$ 0.64	\$ 0.51
Cash flow from operations per share	\$ 1.87	\$ 1.07
Weighted average number of shares outstanding	24,727,002	23,283,800

The number of shares used to calculate diluted earnings and cash flow from operations per share for the year ended December 31, 2001 of 24,727,002 included the weighted average number of shares outstanding 22,599,501 plus 2,127,500 shares related to the dilutive effect of stock options. The number of shares used to calculate diluted earnings and cash flow from operations per share for the year ended December 31, 2000 of 23,283,800 included the weighted average number of shares outstanding of 19,452,588 plus 3,831,212 shares related to the dilutive effect of stock options and warrants.

The respective exercise price of the stock options and warrants excluded from the diluted earnings and cash flow from operations per share calculations for 2001 and 2000 exceeded the average market price of the common shares, and therefore the effect would be anti-dilutive.

The effect for the year ended December 31, 2001 of adopting the treasury stock method resulted in an increase of \$0.01 to diluted net earnings per share (2000 – increase \$0.03) and an increase of \$0.06 to diluted cash flow from operations per share (2000 – increase of \$0.06).

10. Cash Flow Information

The following shows the actual cash amounts paid in the current year excluding any accruals:

	2001	2000
Interest paid	3,691,302	1,144,354
Taxes paid	2,000,000	135,500

11. Commitments

The nature of the Company's operations result in exposure to fluctuations in commodity prices and interest rates. The Company monitors and when appropriate, utilizes derivative financial instruments to manage its exposure to these risks. The Company deals only with major financial institutions and purchasers and does not anticipate non-performance by the counter parties.

The Company uses natural gas agreements to hedge anticipated sales of natural gas. At December 31, 2001, the Company had entered into physical gas contracts at pre-determined prices to sell 4,745,000 GJs (approximately 13,000 GJs per day) at an average price of \$3.34 per GJ in 2002.

Also, at December 31, 2001, the Company had entered into put option contracts at pre-determined floor prices at an average price of \$2.57 for 7,665,000 GJs (approximately 21,000 GJs per day) in 2002.

12. Subsequent Event

The Company signed a purchase and sale agreement with a third party on January 23, 2002 that disposed of the last of the heavy oil properties acquired with the Benson transaction. Proceeds of the disposition included \$1,987,829 of cash, a note receivable for \$500,000, bearing interest at the rate of prime plus two per cent, and 3,750,000 shares of Connacher Oil and Gas Ltd.

13. Comparative Figures

Certain of the comparative figures have been reclassified to conform to the current year presentation.

Corporate Information

Board of Directors

Mark Janisch, P.Eng., MBA
President and Chief Executive Officer
Southward Energy Ltd.

Verne G. Johnson
Independent Businessman

Robert Shaunessy
Chairman
Rio Alto Exploration Ltd.

Marcel J. Tremblay
Chairman and Chief Executive Officer
Overlord Financial Inc.

Management

Mark Janisch, P.Eng., MBA
President and Chief Executive Officer

David Elgie, P.Eng.
Vice President Engineering and
Chief Operating Officer

Barry Herring, C.A.
Vice President Finance and
Chief Financial Officer

Dave Robinson, P.Land
Vice President Land

Thomas Zavesiczky, P.Geol.
Vice President Exploration

Corporate Head Office

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Fax: (403) 266-1814
Email: south@southwardenergy.com
Website: www.southwardenergy.com

Legal Counsel

Macleod Dixon

Bankers

Royal Bank of Canada

Auditors

Deloitte & Touche LLP
Chartered Accountants

Registrar and Transfer Agent

Computershare Trust Company
of Canada

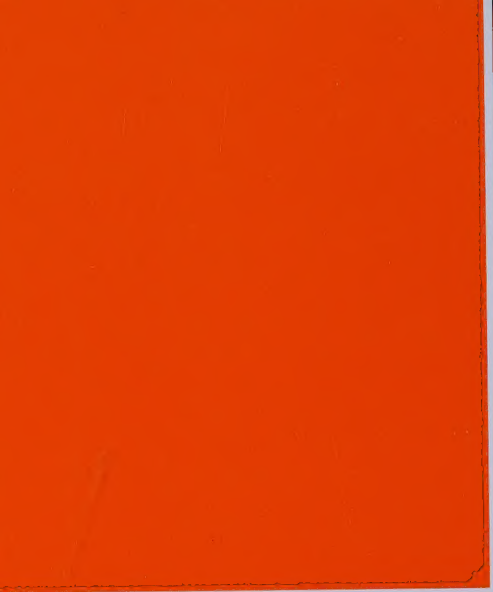
Engineering

McDaniel & Associates

Stock Exchange Listing

The Toronto Stock Exchange
Trading Symbol: SWN





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